

Audit Evidence Supporting the Missing Going Concern Opinions: Bankrupt California Public School Districts

S. Joseph Durden, CPA, PC
John Sennetti, Nova Southeastern University

Because of asymmetric payoffs to the auditor, bankrupt local governmental units are unlikely to receive going concern audit opinions (GCOs). To increase this likelihood, we propose a framework to increase the evidence to support this opinion. We then apply this to 400 California School District reports, 54 of which were used to declare bankruptcy by 2008. Typically, because of the impending bankruptcy, otherwise reliable State financial information becomes unreliable. We address this and then recommend a GCO in 2008 for thirteen of nineteen districts which eventually went bankrupt. We confirm as available: 1) the missing evidence and provide, and 2) an improved information model demanded by auditing research and practice.

Local governments (cities and school districts) across the United States are failing to meet their cash obligations, but few are receiving going concern audit opinions (GCOs). Fifty-four (13.5 percent) of the over 400 possible school district reports in California from 2003 to 2008 actually received bankruptcy designations, and but few of these received GCOs (California Department of Education, 2009). Even though the State of California failed to pay its obligations when they came due, i.e., failed as a going concern, the state's financial statements did not receive a going concern opinion (California State Controller's Office, 2009; Luhby, 2009).

This audit opinion is not intended to predict economic failures, but is relied upon by vendors (teachers, parents and more) as a warning as to possible nonpayment to them when their payments become due. The official guidance for these audit opinions explicitly states the absence of GCO does not imply a bankruptcy will not occur [American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern," AICPA, 1988; see also Gauthier 2005; and Governmental Accounting Standards Board (GASB) 2009, Statement No. 56, "Codification of Accounting and Financial Reporting Guidance contained in the AICPA Statements on Auditing Standards", GASB, 2009]. Because these opinions report on the presentation of the recent year's financial results, auditors must use currently available evidence, available at most a few months past the year end date of the financial statements, to determine whether the governmental unit will be able to meet short-term financial obligations as they become due.

Arguments for and Against Reporting the Opinion

The GASB Statement No.56, instructs auditors to issue these opinions after observing threatening events, such as bond payment defaults, major debt and tax crisis events, noncompliance with statutory capital or reserve requirements, legal proceedings or regulatory proceedings. All this reduces the likelihood of a GCO unless a declared bankruptcy has already occurred, particularly since the GCO may 'cause' bankruptcy, signaling just the potential of a bankruptcy and frightening creditors, and hence the auditor has greater payoffs not to report this opinion, especially when this report may discontinue the relationship with this client.

Against this likelihood, the national financial crises affecting local governments should increase the evidence and demand by creditors, employees' unions, taxpayers, and all other stakeholders for more going concern opinions. Governments missing tax revenues from foreclosed and reduced tax-valued houses have closed police stations in California (Sanchez, 2010), and states have assumed school district debts. Going concern opinions for school districts alert employees to possible job losses, students to possible non accredited high school degrees, and taxpayers to abnormal salaries for officials, as in the cases of Bell, California (Gore, 2009; Roger, 2010).

This paper responds to this national stakeholder demand for more GCOs. We consider the general monitoring process created by the states, one that permits variables to be modeled as part of the auditor's an analytical work. With this we increase the evidence and hence the likelihood for the going concern opinion for governmental units. We then apply this process to the financially-distressed California school districts to find a sufficient framework to increase the going concern opinion evidence. The next section and corresponding sections discuss the relevant research, hypotheses, methodology, results and their summaries.

BACKGROUND AND HYPOTHESIS

General Overview

Like non-governmental audits, governmental audits do not require an analysis to predict the future viability of the local governmental unit being audited. GASB 56 requires certain footnote and MD&A disclosures, however these requirements are still ex-post in nature and not predictive of an event that has already occurred. Because of this, there was no warning or cautionary communication, to vendors, employees, police, fire departments, insurers of homes, local utilities and other vendors of services and products from the local government bankruptcies of the City of Prichard, AL; City of Vallejo, CA, City of Dunmore, PA, Emery Unified School District, CA, West Contra Costa Unified School District, CA, Compton Unified School District, CA, St Louis School District, MO, and the Richmond Unified School District, CA, just to name a few.

Increasing the demand for predictive GCOs began in the United States with the rising inflationary crises of the 1970's, when costs exceeded revenues (and similar to recent deflationary crises with declining revenues). Practicing auditors requested a going concern opinion for those units subject to governmental and public audits (Belluomini, 1977). Absent prior research of these governmental issues, the auditors adopted for-profit opinions (SAS No. 59) and their predictive models, although predictive models for governmental units are now available (Trussel and Patrick, 2009). The for-profit research on these opinions consider the bankruptcy probability (Hopwood, McKeown, and Mutchler, 1994) from perceived variables from other stressed companies (Mutchler, 1984), the predictability of future going concern issues based on prior financial distress (Geiger et al., 2005), the influences of contrary information (Mutchler, Hopwood, and McKeown, 1997), publicly available information (Mutchler, 1985), and user interpretation of the going concern opinions (Ponemon and Raghunandan, 1994).

Whether to Report a Going Concern Opinion: Agency and Other Issues

In addition to the available economic information, the auditor considers whether the effect of the opinion may increase the likelihood of these past negative conditions and bankruptcy, and thereby increasing the corresponding legal liability (Mutchler, 1985; Raghunandan and Rama, 1995; Akers, Maher, and Giacomino, 2003; Carcello and Neal, 2003; Bellovary, Giacomino, and Akers, 2006). A lawsuit from or dismissal by the client may occur even in the presence of predictive evidence (Akers et al., 2003; Carcello and Neal, 2003; Raghunandan and Rama, 1995; Bellovary et al., 2006). In some cases, these conditions create opinion shopping (Carcello and Neal 2003; Bellovary et al., 2006).

Type I and Type II Decision Errors

Two types of misclassifications or auditor errors may occur in reporting. A Type I misclassification occurs when the client remains viable after the issuance of a going concern opinion. Conversely, a Type II misclassification occurs when the client declares bankruptcy after the issuance an unqualified opinion for the period preceding the bankruptcy filing (Geiger et al., 2005). Type II misclassifications are common while Type I are not. Less than half of businesses filing for bankruptcy received a going concern opinion for the preceding financial statements in the 1980's (Hopwood et al. 1989; Raghunandan and Rama, 1995; Geiger et al., 2005).

Asymmetric Payoffs for Type I and Type II Decision Errors

The auditor has a knowledge advantage over the principal (school district taxpayers) because of the "expertise, functional indispensability, and intrinsic ambiguity associated with the services they provide" (Sharma, 1997, 768). The cost to the auditor of a Type I decision is likely a loss of a client. The cost of a Type II decision to the auditor for government auditors, is likely minimal, since their lawsuits for these audits are rare, although the taxpayers may try to harm the auditors' reputations. Opportunism emerges as the auditors decide in their best interests to not issue a GCO.

When a GCO is not given for bankrupt corporations, lawsuits from taxpayers, debt holders and more also arise, but SAS No.59 argues that when one is given it does not mean that the corporation will be solvent, and in this case the auditor is less likely dismissed. When a GCO is not given for bankrupt governmental units, even when subsequent challenges are made to the financial statements, the former city manager is more likely to be sued than the auditors (e.g. Palmeri, 2010). Also, since for the unit, the state may likely assume the debt, the client may continue (but not as the same going concern) so arguments for not giving a GCO remain. Next, because of the time delays due to state takeovers, creditors too are more likely to wait and less likely to sue the auditor. Specifically for

California school districts, there exists an additional funding source (loan) from the State of California after the school district declares insolvency, thereby again reducing the likelihood of taxpayer lawsuits and reducing auditors' concerns of client retention (State of California, 2009), and reducing the likelihood of a GCO.

Next, given the unit's poor financial condition, the collection of the audit fees themselves or even client retention may be in doubt, and since the fees themselves may be so low, or even not sufficiently budgeted, that the corresponding quality of audit itself may low and the GCO evidence produced insufficient for this opinion, following low auditor-budgeted costs. Finally, the first to feel the bankruptcy consequences are the unit's employees, less likely as individuals to sue, but more likely to sue as part of a union, if one is permitted. Again these lawsuits are more likely first against management than the auditors, reducing once again the likelihood of the GCO.

Public Interest Arguments for Increasing the Likelihood of the GCO

Against this, the public interest stakeholders, too numerous to mention and unaware of the consequences of bankruptcy or extreme financial stress conditions, and as voters, do demand more warnings from the accountants. The consequences can be too severe: closed police stations and less protection for cities in California (Sanchez, 2010), failed city water and fire systems and higher housing insurance in Harrisburg, Pennsylvania (McNichol, 2010). In Georgia, bankrupt school districts create non-accredited high school degrees and Las Vegas, Nevada, closed city-supported cancer and kidney units for urgent care. These events argue for increasing the auditors' evidence for the supply of GCOs: The "hope is that issuing a going-concern opinion might promote timelier rescue activity" (Venuti, 2004: 41).

Audit Evidence for the Bankruptcy of Governmental Units

Local governments are able to file for bankruptcy under the Municipal Bankruptcy Act of 1937 and 579 municipalities have filed for bankruptcy since the passage of the legislation (Landry and Deal, 2008). Park (2004) considers the causes of municipal cash shortages and bankruptcies. Research on audit opinions associated with these begins with Belluomini (1977) who provides the variables in Table 1 to be considered before providing a going concern opinion for governmental units.

Table 1: Going Concern Considerations for Governmental Units

1.	Significant interfund receivables or receivables from other governmental units may not be realizable in full; as a result, the unit will have significant cash flow problems.
2.	Taxable property values may be decreasing and/or delinquent taxes as a percentage of the total tax levy may be increasing and the current tax rate may be approaching the maximum legal limit. As a result, if there are no other revenue sources, the unit may not be able to provide adequate levels of service and meet debt obligations.
3.	The unit's actual expenditures may have been in excess of budgeted expenditures for one or more years and/or actual revenues may have fallen short of budgeted revenues for a year or more.
4.	On a per capita basis, bonded debt or expenditures may have increased at a rate in excess of inflation.
5.	Salaries and fringe benefits may have increased as a percentage of total expenditures without an offsetting increase in productivity.
6.	Substantial unfunded pension liabilities requiring significant funding in future years may exist.
7.	The unit may use long term debt to finance current operations or to meet debt service requirements.
8.	There may be increasing amounts of short term borrowings that are not liquidated on a timely basis.
9.	The unit may be unable to issue long term debt to pay off bond anticipation notes.
10.	Enterprise fund activities may not be able to continue as a result of a lack of operating funds, because of continuing operating deficits and/or the failure to obtain grants-in-aid from other governmental units to subsidize operations.
11.	The unit's bonds may be downgraded by a bond rating agency.
12.	The governing body may fail to recognize the seriousness of the unit's financial difficulties and as a result may fail to provide appropriate remedies.

Examples from California School Districts

Consider two "independent" school districts in California, the West Coast Costa and Chico districts. West Coast Costa district received an unqualified opinion and Chico a going concern opinion (a GCO). Both districts have almost identical financial characteristics and should have received a bankrupt rating by the State of California for the same year (June 30, 2008), given by the State and found in the auditor report each given in December 2008, and when the "preliminary negative certification," one signal that bankruptcy was imminent but not yet official for both school districts. Yet, West Coast Costa did not officially receive this final negative certification rating or a GCO, even though the preliminary certification was mentioned in the West Coast Costa Management and Discussion

Analysis footnote for that year (Chico Unified School District 2008; West Costa Contra Unified School District 2008). Apparently the available evidence was insufficient to sustain a GCO. We hypothesize this evidence was available but the framework for finding it was not.

Table 1 begins a framework of signals under which the bankruptcy of governmental units should become more explicit. California adds to this framework by providing the information on the attributes listed in Table 2 of two types of financially stressed districts, those listed as qualified (stressed) and as negative (bankrupt). From the latter we should be able to predict bankrupt districts in August, the time of the audit, for the past school year ending in June, before the list of officially bankrupt districts becomes available from the State of California. However, as the district becomes more stressed, the inputs to these variables may be changing, e.g. the State may be intervening into local districts and making efforts to prevent financial default, by adding resources or closing buildings and consolidating classes. Also, the auditors are not supposed to predict defaults with future information but with current information, which for California schools may be constantly changing and therefore statistically not relevant. In question is whether the State will declare a school negative (bankrupt) after the auditor's opinion has been rendered. So the question remains open as to whether the auditor may unknowingly have sufficient evidence for the GCO, our hypothesis, H.

H: California school district financial reports not given going concern opinions but associated with attributes of bankrupt district reports are likely to contain evidence sufficient to merit going concern opinions.

METHODOLOGY AND RESULTS

Data

Table 2 presents the California Department of Education's Annual Reports covering the fiscal years 2004 through 2008. These reports contained a listing of the school districts that received a (a) positive, (b) qualified, or (c) negative certification. A positive certification indicates a school district or county office of education that will meet its financial obligations for the current fiscal year and subsequent two fiscal years. A qualified certification indicates the school district may not be able to meet its financial obligations during the year, but is not one of substantial doubt, and can be considered similar to the SAS No. 59 condition where notes are given but no reference is made in the opinion, and one that is not a GCO. A negative certification signifies the school district will not meet its financial obligations for the current fiscal year or subsequent fiscal year. We use this qualification as the basis for designating a school district bankrupt.

Design and Framework

Using publicly held financial and non-financial information on variables suggested by for-profit and not-for-profit research, we create in-sample statistical models to identify from troubled school districts, those variables related to the changing conditions from fiscal stability to government intervention. This approach may require different models for different times periods as the conditions of the governmental unit changes from (1) fiscal stability to (2) fiscal instability and finally to (3) bankruptcy. In each case the auditor has an advantage of a preliminary certification (preliminary level 3) by the State of California, six months after the financial statements and about the time of the auditor's report. Often this announcement is designated as a subsequent event.

VARIABLES

First design: Suggested predictive variables

For the California school districts with nine independent (predictive) variables suggested by the CDE, we are interested in predicting bankruptcy, classification 3 in Table 2, the negative certification, our first dependent variable (as $Y = 1$). [We add to the predictive variables the "Other" category, and now identified as a "size" variable, as size is important to all previous research on organizations and in particular for the California School Districts, bringing the total for Table 4 to ten predictive variables].

The modeling is a two-step process. First in Logistic Regression Model 1 we compare the dependent variable, classification 2 ($Y = 1$), the qualified certification, Table 2, to the positive certification, classification 1, Table 2 (for $Y = 0$), giving the 1-2 comparison, in order to determine which of the CDE suggested variables serve to predict financial stress. We would like to identify predictive variables before a stable school district becomes unstable. In Model 2, we then compare the negative certification or bankruptcy, classification 3 ($Y = 1$), to the positive certification, classification 1, Table 2 (again, as $Y = 0$) for the 1-3 comparison, using only those variables of Model

1 found useful in some way for predicting bankruptcy, 1-3. Preliminary negative certifications do not become final until after the end of the school year and are available to auditors during the audit period and therefore an in-sample, same year sample analysis and the GCO can be given before the declaration of bankruptcy is declared.

Second design: All available predictive variables

We repeat the first design. We add one more available predictive variable suggested by prior for-profit going concern opinion research (Geiger et al., 2005), the evidence of prior bankruptcy (1, 0), bringing the total number to eleven independent variables. In creating the variables for the logistic modeling process from Table 2, all predictive variables are coded as 1 if present, 0 otherwise. For the final variables, the evidence of prior bankruptcy (the school district had a previous negative certification), is coded as 1, otherwise 0. For average daily enrollment variable, identified in the model as SIZE AVG, if the school district has an average enrollment greater than 7,916 (which represents the average daily enrollment for all school districts within the data set), the value is set to 1, otherwise 0.

Table 2: California School District Variables

These financial and non-financial indicators were utilized by the California State Controller to determine financial distress experienced by a school district. Fiscal years are July 1 to June 30. (California Department of Education July 2009, July, 2008, October 2007, October 2006, June 2005).

FY 2007-2008	FY 2006-2007	FY 2005-2006	FY 2004-2005
Declining Enrollment ¹	Declining Enrollment	Declining Enrollment	Declining Enrollment
Deficit Spending ²	Deficit Spending	Deficit Spending	Deficit Spending
Revenue Limit ³	Inadequate Reserves	Inadequate Reserves	Inadequate Reserves
Other Expenditures ⁴	Mid-Year Budget Adj.	Encroachment Issues	Special Ed Cont. ⁵
Salary and Benefit Issues	Salary and Benefit Issues	Salary and Benefit Issues	Reserves ⁶
Management Turnover	Health Welfare Benefit Issues	Prior Audit Adjustments	Other Revenues ⁷
Negative Fund Balance	Forest Reserve Funds Loss	Benefit Related Costs	Labor Agreements ⁸
Charter School Issues	Charter School Issues	Other Fund Encroach.	Indept. Position Control ⁹
Other Issues	Other Issues	District Man. Issues	Litigation/Labor Claims

Based on a review of these variables, the school district receives one of three following classifications from the California State Controller:

- Positive: A school district or county office of education that will meet its financial obligations for the current fiscal year and subsequent two fiscal years.
- Qualified: A school district or county office of education that may not meet its financial obligations for the current fiscal year or subsequent two fiscal years.
- Negative: A school district or county office of education that will not be able to meet its financial obligations for the current fiscal year or subsequent fiscal year.
- ¹Declining Enrollment: Enrollment decreased in both the prior and current fiscal years.
- ²Deficit Spending: Unrestricted deficit spending exceeded one-third of available reserves in any of the current or two subsequent fiscal years.
- ³Revenue Limit: Projected revenue limit for any of the current or two subsequent fiscal years changed by more than 2% since budget adoption of first interim.
- ⁴Other Expenditures: Projected operating expenditures (e.g., books and supplies) for the current and two subsequent fiscal years changed by more than 5% since budget adoption or first interim.
- ⁵Contributions: Contributions from unrestricted to restricted resources, or transfers to or from the general fund to cover operating deficits changed by more than \$20,000 and more than 5% since budget adoption for any of the current or two subsequent fiscal years.
- ⁶Reserves: Available reserves (e.g., designated for economic uncertainties, undesignated amounts) did not meet minimum requirements for the current and two subsequent fiscal years.
- ⁷Other Revenues: Projected operating revenues (e.g., federal, other state) for the current and two subsequent fiscal years changed by more than 5% since budget adoption or first interim.
- ⁸Status of Labor Agreements: Salaries and benefit negotiations are unsettled for certificated employees, classified employees, and/or management/supervisor/confidential employees as of budget adoption or second interim projections.
- ⁹Independent Position Control: Personnel position control is independent from the payroll system.

- ¹⁰ Average Daily Attendance: The mean daily attendance was calculated for each year with daily attendance for each school district greater than the mean receives a 1 and less than the mean scores a 0. (SIZE AVG)
- ¹¹ Prior Bankruptcy: A school district receiving a negative classification in a prior reporting period scores a 1 and no negative rating receives a 0.

Table 3: Predictive Variables of School District Bankruptcy Based Upon the CDE**Panel A: Top Three Variables-Begin with 2003 Variables**

Year	Dependent Variables ⁱ	Predictive Variable ⁱⁱ	(Wald Z-value)	Pseudo-R ²
2007-2008	1-2	Declining Enrollment	(1.638)**	0.67485
		Deficit Spending	(0.592)*	
		SIZE AVG	(2.036)*	
	1-3	Declining Enrollment	(1.662)**	0.62814
		Deficit Spending	(0.261)*	
		SIZE AVG	(0.084)*	
2006-2007	1-2	Declining Enrollment	(2.754)**	0.69749
		Deficit Spending	(1.495)*	
		SIZE AVG	(0.952)*	
	1-3	Declining Enrollment	(2.092)**	0.65707
		Deficit Spending	(0.783)*	
		SIZE AVG	(0.058)*	
2003-2004**	1-2	Declining Enrollment	(1.453)**	0.48046
		Deficit Spending	(0.649)*	
		SIZE AVG	(0.151)*	
	1-3	Declining Enrollment	(2.275)**	0.77779
		Deficit Spending	(0.158)*	
		SIZE AVG	(1.877)*	

Panel B: Based Upon All Available Predictive Variables, the Top Three in 2008

Year	Dependent Variables ⁱ	Predictive Variable ⁱⁱ	(Wald Z-value)	Pseudo-R ²
2007-2008	1-2	Prior Bankruptcy	(-1.082)**	0.87475
		Revenue Limit	(2.422)*	
		SIZE AVG	(1.592)*	
	1-3	Prior Bankruptcy	(3.500)**	0.99267
		Revenue Limit	(-0.126)*	
		SIZE AVG	(1.112)*	

* statistically significant, Z score exceeds 1.645 (one sided p-value<0.05)

** data insufficient for logistic modeling for years 2006-2005 and 2005-2004.

i Refer to Table 4: Positive certification (1), Qualified certification (2), Negative certification (3).

ii Refer to Table 4: Footnotes 1-11.

Table 4: Successful Predictions of Classifications**Panel A. State of California classifications by type and year**

Classification	2007-2008	2006-2007	2005-2006	2004-2005	2003-2004	Total
Positive ('1')	27	9	2	13	16	
Qualified ('2')	85	108	19	29	38	
Negative (bankrupt) ('3')	19	13	5	3	14	(13.5%)54
Total	131	130	26	45	68	400

Panel B: Classification by Most Recent Year: Predictive Model for (2007-2008)

Prediction of Positive (1) v Qualified (2) Classification

Classification	Count	Probability Exceeds	% Successfully Predicted (Count)
Positive (1)	27		22.222 (6)
Qualified (2)	85	0.50000	97.647 (84)
Total	112	0.50000	79.464 (90)

Prediction of Positive (1) v Bankruptcy (3) Classification

Classification	Count	Probability Exceeds	% Successfully Predicted (Count)
Positive (1)	27	0.50000	96.296 (26)
Negative (bankruptcy declared) (3)	19	0.50000	68.421 (13)
Total	46		84.783 (39)

School districts in California are required to file interim reports twice a year confirming their status to CDE authorities. During the fiscal year 2007-2008, there were 131 school districts that filed either a qualified or negative certification during either the 1st or 2nd certification filing. If a school district filed either a qualified or negative certification for the 1st certification filing, then if for the 2nd certification the financial condition was improved they received a positive certification for that 2nd certification period. The 131 school districts are thereby classified into three divisions (dependent variables) based on the 2nd certification, there are 19 classified as negative, 85 classified as qualified and 27 classified as positive. The same classification procedure is utilized for the previous years under study. There is insufficient published data on bankrupt schools for the years 2004 to 2006, as the bankruptcies range from 68 in 2004 to 26 in 2006, suggesting improving U.S. and California economic school district conditions as shown in Tables 3 and 4.

Results-necessary and sufficient conditions

Necessary conditions: Tables 1 and 2 and local laws provide the necessary conditions for predicting (in-sample) bankruptcy for governmental units. Tables 3 and 4 present the sufficient conditions following the unique modeling process described earlier. In the first design for the governmental variables given by California, we create a logistic regression model to predict bankruptcy for the year 2003. But we find no one set of variables to serve for every year.

To resolve this issue, Table 3 (Panel A) presents the best (maximum likelihood, pseudo-R-square) three variable logistic model for predicting 2003 to 2004 bankruptcies (the 1-3 Model). We find Declining Enrollment, Size AVG (the school district exceeds average enrollment) as statistically significant and Deficit Spending as the third variable found by the model predictive of bankruptcy (1-3) for the year 2003 to 2004. These two variables, although not statistically significant also appear in the three variable model found for the predictions of the at risk (qualified) condition (1-2) for the year 2003 to 2004. These two statistically significant variables also appear in 2007 to 2008 (1-2) predictions. Although only one of the two (Declining Enrollment) is significant for predicting bankruptcy in that year, both are significant for predicting the qualified condition (1-2 model). Therefore, only Declining Enrollment and the prior bankruptcy of the school districts should be considered (is necessary) in evaluating the bankruptcy of school districts.

Table 3 (Panel B) presents the best (maximum likelihood, pseudo-R-square) three variable logistic model for predicting the most recent year, the 2007 to 2008 bankruptcies (the 1-3 Model) with the most available data and adds one more variable found from adding the non-governmental bankruptcy research variable, Prior Bankruptcy (1,0). The best three variable model does confirm prior bankruptcy as a predictor, as one of three variables in the three variable (1-3) model. It is also statistically significant, but the variables from Table 4 found in Table 5(a) have changed. Prior Bankruptcy and Revenue Limit have replaced Declining Enrollment and Deficit Spending in the (1-2) model. Only Prior Bankruptcy is significant in the bankruptcy (1-3 model). As shown in both Table 3 (a), the partial model, and Table 3 (B), the full model, different variables for different years are predictive of bankruptcy. This can be expected. As the State takes over school districts, it changes them and provides improved funding levels, causing different variables to be predictive each year. It also seems that schools which had prior bankruptcies and exceeded their revenue limits also had declining enrollments and deficit spending, as these variables are collinear.

Sufficient Conditions

Table 4 demonstrates the ability of the full model of variables. In Table 3B, the 1-2 model only agrees with the 1-3 model in the variable, prior bankruptcy, for the most recent year, 2007 to 2008. We see in Table 4 that the 1-3 model has a success rate of around 85%, predicting 13 of the 19 bankruptcies and 26 of the 27 stable school districts, using the preliminary negative rating for the dependent variable. Therefore 13 of the 19 bankruptcies could have been predicted using this full model, two-step approach, and the preliminary information available on bankruptcies from the State of California (California Department of Education, July 2009).

The 19 bankrupt school districts for 2008 we identify as GCO candidates as (see bold): Chico Unified, Orange Center Elementary, El Rancho Unified, Wilsona Elementary, King City Joint Union High, King City Union Elementary, Val Verde Unified, Aromas-San Juan Unified, Julian Union High, La Honda-Pescadero Unified, Pajaro Valley Unified, Santa Cruz City Schools, Travis Unified, Vallejo City Unified, Healdsburg Unified, Piner-Olivet

Union Elementary, Chinese Camp Elementary, Dixon Unified and Westwood Unified. These school districts meet the definition of a going concern opinion under SAS No. 59 and GASB No. 54. The two school districts, West Coast Costa and Chico that seemed very similar, differed in their final certifications. West Coast Costa, although similar to Chico in financial characteristics, was not identified as a bankrupt school by the State, and it also would not qualify in our process as sufficient for a GCO since it has no prior negative certification before its preliminary negative certification. Table 6 shows one other district (Willows Unified) is identified when the model is applied to 27 the positive certification districts, creating a Type I error of 1/27 or 3.7%, and bringing the total to fourteen districts recommended for a GCO.

Summary and Conclusion

This research presents a process to increase the evidence for the going concern opinion for local governmental units and applies it to the California school districts. This process first identifies relevant variables from a database constructed by the State of California, the stakeholder must likely to assume the district's debt. It then adds relevant unique variables from general bankruptcy research. Statistical analysis presents only one of these, whether or not a prior bankruptcy exists. These changing models are unique to local government bankruptcies because as stress occurs, changes in the values and in the importance of each variable follow as consequences. For example, the variable "revenue changes," may be an important stress variable prior to bankruptcy, but is not a consistent predictor as is the variable, "prior bankruptcy." We see in Table 2 and in Table 3 that the State of California predictor variables vary by year, and then must be confirmed by comparing the (1-2) analysis models with the (1-3) predictive models.

Contributions to Practice

We respond to a specific request: "Additional research into the development and application of such financial predictor models for governments would enhance the models and, in the long run, serve the interests of the taxpayers." (Ghany 2009, 40). Under our process it is likely that some local governments now exist as undeclared going concern candidates. Current economic downtown and numerous media reports of government financial distress (the closing of police stations, fire departments and schools) underscore the demand for more GCOs.

Contributions to Prior Research

This research adds to Ghany (2009), Landry and Deal (2008), Kloha et al. (2005), Gauthier (2005), Venuti (2004), Brown (1993), Belluomini (1977) and Trussel and Patrick (2009), by adding a framework to find predictive models, as no one model is or will ever be sufficient by itself, given changing a) state and local laws and regulations, b) economic conditions and c) forms of governmental units.

Limitations

The generalization of our results and the extension of their external validity to all local governmental units is limited: 1) to sample analysis which in this case consists of only the school districts in California, 2) to the number of bankruptcies for any year, as only 19 were given for 2008 (and only 26 in Kansas City (Associated Press, 2010), 3) to the state's extensive database of variables which varies by state, and 4) to the availability of early and preliminary negative confirmations (potential bankruptcies, which although not certain give weight to the auditor who files a GCO for that same year) and those states in similar financial conditions which do give preliminary signals, such as Kansas City, (Missouri) Detroit (Michigan), Germantown (Pennsylvania), Harrisburg (Pennsylvania) and St. Mary Parish (Louisiana.), just to name a few (Gundle-Krieg 2009; Kersey and Van Beek 2009; Eisele-Dyrli 2010; Hepp 2010; Hollingsworth, 2009).

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S. Joseph Durden is a CPA, PC. He has given going concern audit opinions to some governmental units. His publications include Issues in Accounting Education of the American Accounting Association.

John Sennetti is a professor of graduate statistics and accounting at Nova Southeastern University. He received his Ph.D. from Virginia Tech. He supports the research of his graduate students, and has also published in Auditing: A Journal of Practice and Theory, Journal of Finance, Journal of Business Ethics, Advances in Accounting Behavioral Research, and other.